

**STATE OF VERMONT
PUBLIC SERVICE BOARD**

Docket 7270: Joint Petition of Verizon New England Inc., d/b/a Verizon Vermont, Certain Affiliates Thereof, and FairPoint Communications, Inc. for approval of an asset transfer, acquisition of control by merger and associated transactions

**Rebuttal Testimony
of**

RANDY BARBER

**On Behalf of the
Communications Workers of America and
International Brotherhood of Electrical Workers**

REDACTED – PUBLIC VERSION

August 10, 2007

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1 **Q. Please state your name.**

2 A. Randy Barber

3 **Q. Are you the same Randy Barber who previously filed testimony on behalf of the**
4 **Labor Intervenors in this proceeding?**

5 A. Yes.

6 **Q. What is the purpose of your public rebuttal testimony?**

7 A. My public rebuttal testimony is intended, in part, to respond to certain statements made
8 by FairPoint rebuttal witnesses Leach, Balhoff and King, and, in part, to supplement my
9 public direct testimony with analyses of information that was not available to me at the
10 time it was filed.

11 ***A. Replies to Certain Statements Made by FairPoint Rebuttal Witnesses***
12

13 **Q. How would you characterize the three FairPoint witnesses' rebuttal of your**
14 **testimony?**

15 A. Collectively, witnesses Leach, Balhoff and King make a number of arguments in
16 refutation of my pre-filed testimony. I will list what I believe to be their key arguments
17 and then discuss each in turn.¹ The FairPoint rebuttal witnesses make the following
18 broad arguments:

19 1) FairPoint's financial case is not "extremely optimistic," its financial
20 projections contain a "substantial 'margin of error'" and its plans and
21 assumptions are reasonable, even conservative. Concerns about the riskiness

¹ In addition, the "Supplemental Testimony Based on New or Updated Information" sections of my public and confidential testimony also contain analyses that are directly responsive to the FairPoint witnesses' assertions.

1 of the proposed transaction are misplaced, since FairPoint’s model has a
2 significant cushion built-in.

- 3 2) Since FairPoint has a track record of successfully acquiring and integrating
4 over 30 RLECs, it is perfectly capable of applying this expertise to Verizon
5 NNE.
- 6 3) Past is not prologue: the historic performance of both FairPoint and NNE
7 (under Verizon’s control) is not relevant to projections for NNE under
8 FairPoint’s control, nor for comparison with their peers.
- 9 4) Comparison with FairPoint’s peers (or “guideline companies”) reveals that the
10 company’s projections are reasonable and within an acceptable range of these
11 firms’ key financial metrics. Indeed, such a comparison illustrates significant
12 “upside” opportunities for FairPoint.
- 13 5) My analysis consistently disregards the possibility of potential “upsides” to
14 FairPoint’s revenue projections.
- 15 6) FairPoint’s projections for “synergies” (or operating “efficiencies”) and for
16 trends in operating expenses through 2015 are reasonable.
- 17 7) The most useful analysis of FairPoint’s operating expense projections would
18 focus on direct cash operating expense, excluding depreciation and
19 amortization.
- 20 8) Suggestions that more of FairPoint’s projected depreciation than planned be
21 reinvested in NNE are misplaced and ignores industry trends; indeed,
22 precisely because of technology and telecom industry trends, FairPoint has no

1 need to plan for significantly higher capital expenditures beyond what is
2 provided for in its model.

3 9) A focus on “book” equity is misplaced and not indicative of the true status of
4 FairPoint; negative shareholder equity is irrelevant as long as FairPoint has
5 the cash flow to meet all of its obligations.

6 10) FairPoint’s plans for NNE do not pose a risk of “disinvestment” or
7 “cannibalization.”

8 11) FairPoint does not restrain capital expenditures in favor of dividends.

9 12) FairPoint will not put the interests of shareholders before those of its
10 customers, employees, and communities, and it is FairPoint shareholders who
11 will be most at risk should the company confront difficult choices occasioned
12 by a financial crisis.

13 13) FairPoint did not enter into this transaction out of desperation, and it certainly
14 does not represent a “hail Mary” on the company’s part.

15 **Q. Do you agree with any of FairPoint’s criticisms of your analysis?**

16 A. No, I do not, as I will explain in detail below.

17 **Q. Does FairPoint’s rebuttal testimony change your opinion of, or recommendations**
18 **about, the proposed transaction?**

19 A. No, they do not. I have carefully considered FairPoint’s rebuttal testimony, but I find its
20 arguments to be misplaced or largely irrelevant to the overall question of whether
21 FairPoint is financially fit to own and operate Verizon’s Northern New England system,
22 including Verizon Vermont.

1 **Q. Please reply to FairPoint’s assertions that its financial case is not “extremely**
2 **optimistic,” its financial projections contain a “substantial ‘margin of error’” and**
3 **its plans and assumptions are reasonable, even conservative.**

4 **A.** Frankly, this is the nub of the argument. FairPoint and its witnesses argue that their
5 projections are reasonable, even conservative, and that the company’s plans contain
6 more-than-sufficient cushions for any unforeseen negative variances. The purported
7 conservatism of FairPoint’s projections is the foundation of the company’s arguments in
8 favor of this transaction. Based on this, FairPoint urges regulators, employees, customers
9 and communities in the Northern New England states to trust it to figure out a way to
10 adequately implement its plans.

11 Of course, this presumes that FairPoint is broadly correct about:

- 12 • The cost and duration of the transition from Verizon to new FairPoint systems;
- 13 • the state of the Verizon plant and network that it wants to inherit and the capital
14 and operating expenditures that will be required to operate it in an acceptable
15 manner;
- 16 • the cost and adequacy of its DSL expansion plans;
- 17 • its ability to recover revenues from lost access lines and other competitive impacts
18 through improved bundling of services; and
- 19 • FairPoint’s ability to achieve very substantial and recurring “synergies,” while
20 holding down unit operating expense growth at historically low levels.

21 As I demonstrate throughout my direct and rebuttal testimonies (public and
22 confidential), FairPoint’s projections, particularly but not limited to operating expenses,
23 indeed appear to be “extremely optimistic.”

1 If FairPoint is materially wrong about its ability to execute on these combined
2 fronts, I believe it will find itself in a very difficult situation where, as I describe
3 elsewhere, the risks will not just be paid by the company's shareholders.

4 Regarding the riskiness of FairPoint's transition plans, DPS consulting witness,
5 W. Curtis Mills, Jr., was asked in discovery: "Are you aware of any other situation
6 similar in scope and magnitude where, in your words, 'the replacement of most or all
7 operational and business systems [is] simultaneous with the integration and conversion of
8 over 1,500,000 new customers?'" To which Mills replied: "I am not aware of any
9 projects similar in scope and magnitude where the new implementation of most or all
10 operational and business systems occurred simultaneously with the integration and
11 conversion of over 1,500,000 new customers."²

12 **Q. Mr. Leach claims that "many traditional transactional risks are greatly reduced"**
13 **because NNE will "function as a standalone business" (Leach rebuttal p. 55). Do**
14 **you agree with his assessment?**

15 A. No, I do not. His statement ignores the fact that FairPoint needs to expend over \$200
16 million to replace the 600 Verizon back office and network systems. Mr. Leach's
17 confidence is particularly unconvincing when read in conjunction with an earlier, related
18 FairPoint misjudgment where in a PowerPoint slide by an unidentified FairPoint
19 executive, the following assertion – in hindsight – evinces a remarkable degree of
20 FairPoint overconfidence:

² Labor 6-13

1 **{Begin Confidential**

2
3
4
5
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7
8
9 **End Confidential}**³

10 FairPoint argues that it has successfully – and conservatively – projected the
11 results of its past acquisitions.⁴ However, as I demonstrated in my direct confidential
12 testimony, FairPoint has fairly recently been unable to accurately project its results over
13 even a two-year period, much less the eight-year period it attempts to project in this case.
14 As I discussed in my direct testimony, in a 2004 presentation, FairPoint missed its 2006
15 projected net unit operating margin by **{Begin Confidential End Confidential}**.⁵

16 **Q. Please respond to FairPoint’s assertion that its track record of successfully**
17 **acquiring and integrating over 30 RLECs, makes it capable of applying this**
18 **expertise to the Verizon NNE.**

19 A. While FairPoint has indeed acquired over 30 RLECs, these transactions were absolutely
20 minuscule in comparison. It is hardly credible to argue, as does FairPoint witness,
21 William E. King, that the company’s 14-year history of identifying and acquiring “small,
22 typically family-held or closely held telephone companies which can benefit from
23 FairPoint’s larger scale and more sophisticated business methods and processes”⁶ has
24 prepared it for the Verizon NNE transaction.

³ HSR 0066

⁴ See Leach Rebuttal, pp. 28-30

⁵ Confidential Schedule 19 and discussion on pp. 18-19 of Barber Direct Confidential Testimony

⁶ King Rebuttal, p. 28

1 Certainly in all but perhaps the initial few of these transactions, FairPoint was the
2 larger, better-resourced company. There is no comparison to the sheer magnitude and
3 complexity of the challenges facing FairPoint in the proposed acquisition of the dominant
4 carrier in a three-state region. A clear indication of this fact is that FairPoint is required
5 to invest some \$200 million for back office, networking, billing and customer care
6 systems that it does not have.

7 As I mentioned in my direct testimony, FairPoint's history with the only other
8 initiative that comes even close in magnitude to this transaction, the CLEC venture in the
9 late 1990s and early 2000s, is far from a comforting example of FairPoint's ability to
10 implement its plans, particularly in a challenging environment. While Walter Leach
11 disputed my characterization of FairPoint's failed CLEC initiative⁷, he acknowledged
12 that "at its peak the CLEC operation was about twice as large as FairPoint's then largest
13 single company . . . At its peak, the CLEC operation would have been twice as large as
14 FairPoint's largest company today, but would be less than half as large as the total
15 FairPoint operations today." He also acknowledged that the CLEC business was the only
16 separate reportable segment among FairPoint's subsidiaries and that it accounted for
17 more than half of FairPoint's capital expenditures in 2000. In addition, he acknowledged
18 that FairPoint lost in excess of \$200 million on this venture.⁸

⁷ Leach Rebuttal, pp 59-61

⁸ A.CWA/IBEW:FP.3-15

1 **Q. Please respond to FairPoint’s assertion that the historic performance of both**
2 **FairPoint and NNE (under Verizon’s control) is not relevant to projections for NNE**
3 **under FairPoint’s control, nor for comparison with their peers.**

4 A. Mr. King argues that my public testimony is flawed in part because I analyzed Verizon
5 NNE’s and FairPoint’s historic unit operating expense and then compared these results to
6 FairPoint’s projections for NNE over the 2008 – 2015 timeframe. Mr. King argues that
7 comparing FairPoint’s future projections to a selected group of companies’ historic data
8 is superior to looking at FairPoint’s and Verizon’s actual operating experience. Indeed,
9 Mr. King acknowledges that he did not perform any analyses of the specific history,
10 structure, markets, or location of these “guideline” companies other than applying his
11 initial selection criteria and performing limited financial computations.⁹ Moreover, Mr.
12 King does not analyze trends for these companies; he simply identifies specific data
13 points as of either March 31, 2007 or year-end 2006, and then “tests” FairPoint’s
14 projections against them.

15 **Q. Did Mr. King perform an “apples to apples” comparison?**

16 A. No, he did not. Mr. King compared FairPoint’s 2009 and later projections with data for
17 other companies from roughly three years earlier (year-end 2006 or first quarter 2007).
18 He did not make any adjustments to account for the differences in time periods. Thus, he
19 not only ignores the impacts of inflation, he also fails to account for FairPoint’s and
20 Verizon’s historic increases in operating experiences that have been in the range of 6%
21 per year, as I discussed in my direct testimony.

⁹ A:CWA/IBEW:FP.3-27

1 **Q. Did Mr. King compare FairPoint to an appropriate comparison group of**
2 **companies?**

3 A. No, he did not. In making his selections, Mr. King excluded the company that is going
4 through the same process that FairPoint must undertake: Hawaiian Telecom (HT). In his
5 testimony, Mr. King claimed he excluded HT because it was new, but he included
6 another newly spun off company, Windstream. In response to CWA/IBEW data request
7 3-27, Mr. King explained that he excluded HT, which has experienced the types of
8 problems many fear that FairPoint will face, precisely because it had these problems:
9 “Hawaiian Telecom ... has experienced well-documented difficulties transitioning back-
10 office functions from Verizon. . . In selecting guideline companies, Hawaiian Telecom
11 was dismissed because its financial results . . . continued to reflect transition-related costs
12 that Mr. King did not believe reflected normalized operations.” On the other hand, he
13 included Windstream, which didn’t need to go through the wrenching experience of
14 replicating back office and network systems, precisely because the company was able to
15 avoid such an exercise: “Windstream acquired the existing back office systems and
16 personnel associated with Alltel’s former wireline properties, which Mr. King believes
17 minimized transition-related costs thereby preserving the relevance of Windstream’s
18 2006 and first quarter 2007 financial results for comparison purposes.”

19 But FairPoint must go through the same transition process that HT went through.
20 It will not have Windstream’s benefit of being able to keep the existing back office and
21 network operations systems that were already in place.

1 **Q. Do you agree with Mr. King’s conclusion that comparing FairPoint with its peers**
2 **reveals that the company’s projections are reasonable and within an acceptable**
3 **range of these firms’ key financial metrics?**

4 A. No, I do not. Mr. King’s collection of “guideline” companies and comparison tables miss
5 the point. Mr. King uncritically accepted FairPoint’s projections for 2009 and beyond,
6 and the compared them with actual operating performance for non-dominant carriers for
7 2006 or early 2007. He does not appear to have actually performed any evaluations of
8 the actual functioning of FairPoint’s model. Nor does he appear to have performed any
9 “sensitivity” analyses beyond applying his professional judgment as to the credibility of
10 FairPoint’s projections.

11 One would expect that the guideline companies’ 2009 metrics, if he had projected
12 them, would have at least reflected some level of inflation. Indeed, when asked what he
13 would project the guideline companies’ per access line costs to be in 2009, King’s reply
14 was that he “was not asked to perform the requisite analysis necessary to provide such a
15 projection.”¹⁰

16 I find this statement to be quite revealing, and entirely consistent with Mr. King’s
17 passive acceptance of FairPoint’s overall projections. One would think that a
18 fundamental part of performing his analysis would be to normalize the data in some way
19 for the purposes comparison. One would also think that Mr. King wouldn’t need to be
20 asked to ensure that he was making apples-to-apples comparisons. Even though he is
21 comparing “peer” data that are three years out of phase with – and behind – FairPoint’s
22 projected metrics, the FairPoint numbers quite consistently come in well below any of the

¹⁰ A.CWA/IBEW:FP.3-23

1 three combinations of guideline companies to which they are compared (eight of 12
2 observations).

3 In other words, Mr. King's analysis shows that FairPoint's projected expenses in
4 2009 are generally less than what its so-called peers experienced in 2006 and early 2007.

5 **Q. Can you be more specific?**

6 A. Yes. Mr. King's analysis shows that FairPoint's projections for 2009 are less than the
7 median of its "peers" for 2006 or early 2007 on each of the following measures: unit
8 cash operating expense per access line and per connection, and unit capital expenditures
9 per access line and per connection. Keep in mind that he is comparing FairPoint's 2009
10 per-access-line projections with the various guideline company's results from several
11 years before.

12 For example, FairPoint's projected cash operating expense per access line in 2009
13 is **{Begin Confidential End Confidential}** while for a larger guideline grouping of
14 companies (Citizens, CenturyTel, and Windstream) the median is \$515. For what King
15 identified as FairPoint's current peer group (FairPoint, Iowa Telecom, Consolidated
16 Communications, Alaska Communications, and pre-July 2006 Valor Communications) it
17 is \$562, and for the combined guideline companies it is \$537. Indeed, FairPoint's 2015
18 projected unit operating expenses, at **{Begin Confidential End Confidential}**, are
19 lower than its "peer" group's most recently reported actual expenses.

20 Mr. King records – and endorses as "reasonable" – even more significant
21 differences for cash operating expense per connection, as well as capital expenditures per
22 access line and per connection. FairPoint's projected 2009 cash operating expense per
23 connection is **{Begin Confidential End Confidential}**, while for the guideline

1 companies (in the order previously listed) the medians were \$432, \$497 and \$464;
2 FairPoint's projected 2015 operating expense per connection, at **{Begin Confidential**
3 **End Confidential}**, is below the historic medians for all three guideline groups,
4 again based on unadjusted 2006 or early 2007 data.

5 **Q. Are Mr. King's comparisons of revenues equally flawed?**

6 A. Yes, they are. Mr. King shows that FairPoint's revenue projections are less than
7 FairPoint's so-called peers actually experienced in 2006 and early 2007 (operating cash
8 flow and operating income margins, and revenue per access line and per connection, all
9 are significantly below guideline company medians). Rather than trying to analyze the
10 reasons for this, Mr. King takes this as a sign that FairPoint has been conservative in its
11 projections and that it has significant upside potential. King argues that, since NNE's
12 projected future revenue and margin metrics are below those of "guideline" companies,
13 FairPoint will have an opportunity to increase revenues, cash flows and operating income
14 above levels projected in the model. However, he does not appear to have performed any
15 analyses of the reasons that FairPoint projections are lower, including the presence in
16 NNE's largest markets of competition from cable, wireless and other carriers.

17 **Q. Are Mr. King's comparisons of capital expenditures any better?**

18 A. No, they are not. With per-access-line and per-connection capital expenditures, the story
19 is basically the same. FairPoint's projected per-access-line capital expenditures in 2009
20 are **{Begin Confidential End Confidential}**, while for the guideline companies
21 (again, in the order previously listed) the medians were \$122, \$125, and \$124.
22 FairPoint's projected 2015 capital expenditures per access line, at **{Begin Confidential**

1 **End Confidential**}, is below the historic medians for two of the three guideline
2 groupings.

3 Finally, FairPoint’s projected per-connection capital expenditures in 2009 are
4 **{Begin Confidential End Confidential}**, while for the guideline companies (again,
5 in the order previously listed) the medians were \$105, \$109, and \$108; FairPoint’s
6 projected 2015 capital expenditures per connection, at **{Begin Confidential End**
7 **Confidential}**, is far below the historic medians – again based on 2006 or early 2007 data
8 – for all three guideline groupings.

9 **Q. What do you conclude from Mr. King’s analysis?**

10 A. As I mentioned at the outset, King’s analysis is interesting, but it fails to support his
11 conclusions. His analysis confirms that FairPoint’s projections of operating expenses and
12 capital expenditures are extremely optimistic and not in line with the historic experience
13 of FairPoint, the historic experience of Verizon, or the historic experience of FairPoint’s
14 peer companies.

15 **Q. FairPoint criticizes you for disregarding the possibility of potential “upsides” to**
16 **FairPoint’s projections. Is this accurate?**

17 A. Yes, it is correct. While FairPoint and its witnesses have argued that there is a strong
18 potential revenue “upside” to its revenue projections, these have not been quantified
19 (other than the 2012 cash flow sensitivity analysis submitted by witness Balhoff in his
20 confidential direct testimony). And they do not provide any countervailing analysis of
21 the potential for accelerating erosion in FairPoint revenues to cable, wireless and other
22 competitors.

1 Also, there are a number of quite obvious – and alarming – downside scenarios,
2 beginning with the possibility that FairPoint will not be able to achieve the synergies it
3 projects. In addition, the transition from Verizon’s back office and network systems is
4 obviously a quite high-risk endeavor, as witnessed by the experience that Hawaiian
5 Telecom continues to go through. Then there is the fact that FairPoint is projecting
6 increases in unit operating expenses that are significantly below either FairPoint’s or
7 Verizon NNE’s historic trends.

8 More to the point, from the very beginning, my concern has been that this
9 transaction appears to pose inordinate risks to NNE’s customers, employees and
10 communities, as well as to current and future FairPoint shareholders should the
11 transaction be approved. FairPoint has made the case about what will happen if things go
12 “right.” One of my basic tasks is to identify and evaluate what could happen if they
13 don’t. That is the very nature of understanding risk.

14 One can certainly hope that FairPoint exceeds its projections, but the
15 consequences of over-performance are very different from those of under-performance.
16 As I argue below, FairPoint’s shareholders and creditors very likely have broadly
17 diversified portfolios, where gains or losses on FairPoint investments or loans – even if
18 very large – will have a comparatively small impact. On the other hand, the core Verizon
19 NNE constituencies – customers, employees, communities – are much more dependant
20 on NNE and thus have a much less diversified “whole portfolio” than do institutional
21 investors and lenders with respect to the risks associated with this transaction.

22 Stated differently, FairPoint’s customers, employees, and the communities it
23 serves do not have the ability to diversify their exposure to the downside risks if

1 FairPoint is overly optimistic. Thus, customers, employees, and communities need to
2 have a level of protection – to be provided by this Board – that exceeds the level of
3 protection that investors have negotiated through loan covenants.

4 In my opinion, the potential consequences of failure far outweigh the potential
5 benefits of overachievement.

6 **Q. Do you accept FairPoint’s argument that its projections for “synergies” (or**
7 **operating “efficiencies”) and for trends in operating expense through 2015 are**
8 **reasonable?**

9 A. No, I do not. As I argue elsewhere, FairPoint’s unit operating expense projections are far
10 below the historic trends for either it or Verizon. FairPoint and its witnesses argue that
11 the company will be able to implement its very low-growth unit operating expense
12 scenario. I present evidence that such assumptions run contrary not only to the trends
13 that I have analyzed, but even those presented by FairPoint witness King.

14 FairPoint has provided a spreadsheet that generated the one-page “synergies”
15 explication that was attached to DPS.FP.1-86.¹¹ This is what I refer to as the Synergies
16 Model in my confidential rebuttal testimony and in its Attachment A. This model is
17 directly linked, and dependent upon, the Discovery Model via a key worksheet, that is
18 virtually identical to one in the Discovery Model, except that all of its cells are hard-
19 coded.¹²

20 One key difficulty in evaluating FairPoint’s projected synergies is that this model
21 has a number of important numbers that are directly or indirectly hard-coded, even on its

¹¹ This spreadsheet is Attachment A.DPS.FP.1-86.2 (Supplement)

¹² The equivalent Discovery Model worksheet has far more hard-coded cells than I believe is appropriate for a model such as the DM; however, it does have many traceable formulas as well.

1 summary worksheet. FairPoint’s synergies analysis represents the difference between
2 projected costs for NNE if Verizon continued to own the system and FairPoint’s
3 projected costs. Key synergies numbers that are hard-coded on the summary page, and
4 thus not at all transparent, are projected savings from software depreciation and
5 programming, at {Begin Confidential End Confidential}
6 respectively, accounting for {Begin Confidential End Confidential} of FairPoint’s
7 “Eliminated LEC costs,” and Shared Asset Rents, at {Begin Confidential
8 End Confidential}. Thus, it is not possible to see how FairPoint developed at
9 least {Begin Confidential End Confidential} of the projected synergy savings.

10 **Q. Do you agree with FairPoint that the most useful analysis of FairPoint’s operating**
11 **expense projections would focus on direct cash operating expense, to the exclusion**
12 **of depreciation and amortization?**

13 **A.** No, I disagree. In my view, any analysis of FairPoint’s projections for operating
14 expenses that excludes depreciation and other non-cash items, provides only a partial
15 picture and a short-sighted one at that. While it is important to understand the cash flow
16 implications of FairPoint’s operating expense projections, such non-cash expenses are
17 recognized for very good reasons: depreciation is designed to permit companies to
18 recognize past investments that they have made and to fund the replacement of obsolete
19 or worn out plant and equipment. Non-cash OPEB charges are a liability that a company
20 recognizes via its balance sheet and represent a claim against future earnings (or net
21 assets). These and other non-cash charges should be recognized and incorporated in the
22 evaluation of FairPoint’s projections and future plans. Indeed, the way non-cash

1 expenses such as D&A and OPEB are treated are, in my view, integral to an
2 understanding of the long term prospects of the company.

3 Nevertheless, in my confidential rebuttal testimony,¹³ I present an analysis that, I
4 believe, is even more of a “true cash” analysis than I have seen produced by FairPoint or
5 its witnesses. The difference is that I also exclude non-cash OPEBs which, while not
6 nearly as large as depreciation, are projected to total {**Begin Confidential**
7 **End Confidential**} over the 2008-2015 period. An accurate cash-only analysis would
8 excluded depreciation (which is declining) and non-cash OPEBs (which are increasing).
9 When this is done, it shows that FairPoint is indeed projecting that its cash operating
10 expenses will be declining over the 2008-2015 time period. This defies the historic
11 experience of both FairPoint and Verizon.

12 **Q. FairPoint disagrees with the attention you paid to capital investment compared to**
13 **depreciation expense recoveries. How do you respond?**

14 A. My intent in focusing on capital expenditures and dividend payments compared to
15 depreciation expense and net income was to show where FairPoint’s priorities lie. In my
16 opinion, FairPoint’s projections indicate a company that is not interested in providing
17 Vermont, Maine, and New Hampshire with a telecommunications network that is ready
18 for the 21st Century. Rather, FairPoint’s priority is to bring the systems up to minimally
19 acceptable service standards, and provide a portion of the service area with access to data
20 technology that is quickly becoming outmoded.

¹³ Barber confidential rebuttal, pp. 3-4; Confidential Schedule 5R, SPINCO LEC Cash Run-Rate Operating Expense (Absolute and Unit)

1 This case is not about what other telephone companies are doing in other places
2 around the country. It should be about what is needed here in Northern New England.
3 There can be no question that very substantial capital investments are needed in the
4 region's telecommunications network. Yet FairPoint is planning to spend nearly three
5 times as much per year to pay dividends to its stockholders than it will spend to upgrade
6 NNE's physical plant.

7 Instead of striving only to meet minimum standards and ameliorate line losses,
8 FairPoint should be focused on what it will take to operate a company that delivers
9 world-class telecommunications services to its customers. Instead of using its cash flows
10 to fund one of the highest dividends in the country, FairPoint should be building the
11 telecom network of the future. In essence, the \$142 million annual planned dividends
12 represent a lost opportunity each year.

13 **Q. FairPoint also criticizes you for focusing on shareholder equity. FairPoint claims**
14 **that negative shareholder equity is irrelevant as long as FairPoint has the cash flow**
15 **to meet all of its obligations. Do you agree?**

16 A. No, I do not agree. A company's balance sheet, including its "book" shareholder equity
17 account, is a fundamental method of "keeping score" about a firm's relative financial
18 health and prospects. It is true that some companies with negative shareholder equity are
19 profitable and viewed favorably by the financial markets, particularly where the firm's
20 prospects are to reduce the negative balance over time. However, most such cases of
21 which I am aware involve post-transaction accounting conventions and are not regarded
22 as an acceptable long-term condition.

1 In my view, the critical issue when evaluating shareholder equity accounts is the
2 *direction of change over time* rather than absolute levels (although they are important
3 too). I am very concerned about the fact that FairPoint, according to the January 2007
4 projections that it filed with the SEC, is actually planning a decline of over \$700 million
5 in shareholder equity during the first eight years after the transaction. In those
6 projections for the period 2008-2015, FairPoint's book shareholder equity goes from a
7 positive \$490 million to a negative \$218 million, a planned negative \$708 negative
8 change. As I have argued elsewhere, I believe that this decline stems from FairPoint's
9 plan (as presented to its Board of Directors) to pay out substantially more in dividends
10 than it earns each year (thus removing cash from the company's shareholder accounts).

11 Defending this plan, FairPoint's Walter Leach argued in his rebuttal testimony
12 cited the Sprint spin-off, Embarq, as an example of a company whose "opening equity
13 account was *negative* despite being a profitable business with several million access
14 lines."¹⁴ Subsequently, in reply to a data request, Leach stated: "Embarq's opening
15 equity balance was and continues to be negative. The CWA/IBEW has urged that a
16 negative equity position is indicative of a non-viable business plan. Embarq provides
17 concrete evidence that this is not the case."¹⁵

18 Less than a week after Mr. Leach made this statement, Embarq issued its 2nd
19 quarter 2007 SEC Form 10Q, reporting that the company had a positive shareholder

¹⁴ Leach Rebuttal, p. 16

¹⁵ A.CWA/IBEW:FP.3-10

equity account of \$35 million, a \$503 improvement from year-end 2006 and only a year from the spin-off that created its negative shareholder account in the first place.¹⁶

Q. FairPoint takes issue with your characterization of its plans as being “disinvestment” or “cannibalization.” How do you respond?

A. FairPoint may not like the words I used, but it does not take issue with the fundamental facts I relied upon, including:

- projected declines in shareholder equity of \$708 million over eight years;
- a 39.5% reduction in Property Plant and Equipment (\$780 million);
- \$843 million more in depreciation than capital expenditures (58.7% more); and
- dividend pay-outs of \$1.1 billion on only \$248 million in net income.

Q. FairPoint alleges that it does not restrain capital expenditures in favor of dividends. Do you agree?

A. I agree that there is no direct evidence that FairPoint has made an explicit decision to do this, but this is precisely the effect of its actions. FairPoint and its witnesses believe that the company needs to have high dividends in order to compensate shareholders for investing in a firm with slow growth prospects.¹⁷

From my observations, it is clear that in its planning process, FairPoint treats dividends as a fixed cash item, not a variable of net income or any other measure. This is simply a fundamental assumption every FairPoint projection that I have seen (other than

¹⁶ Embarq, SEC Form 10Q, August 1, 2007, p. 4. As I discuss below, part of the improvement in Embarq’s shareholder equity came at the price of reduced retiree health care and other post retirement benefits (OPEBs), which accounted for \$196 million, or 39%, of the positive change in shareholder equity.

¹⁷ See Balhoff Rebuttal, p. 13 and King Rebuttal, pp. 26ff

1 one set of relatively early alternative projections generated by one of FairPoint's financial
2 advisors).

3 In my view, this creates a powerful incentive to structure other cash-impacting
4 plans (such as capital expenditures) to fit around these pre-determined expenditures. For
5 example, deployment of DSL is understood to be much less expensive than fiber to the
6 home (FTTH), even though the latter provides a much superior platform for voice, data,
7 telephony, television and other advanced telecommunications services. The one-time \$42
8 million that FairPoint intends to invest in upgraded DSL facilities in NNE represents less
9 than one-third of a single year's worth of planned FairPoint dividends. I believe that
10 FairPoint's DSL expansion plans in NNE represent what could be called "broadband on
11 the cheap" which, consciously or serendipitously, certainly fits into FairPoint's dividend-
12 driven cash flow models.

13 **Q. FairPoint asserts that it will not put the interests of shareholders before those of its**
14 **customers, employees, and communities, and it is FairPoint shareholders who will**
15 **be most at risk should the company confront difficult choices occasioned by a**
16 **financial crisis. How do you respond?**

17 **A.** As I have argued, there are significant potential risks to all FairPoint constituencies. It is
18 likely, though, that some constituencies would be more severely impacted than others. It
19 is my opinion that, if this transaction proceeds, the risks of the deal will be allocated, in
20 declining order, to employees, customers, communities and the state, shareholders, and
21 lenders. Based on my experience with employers and industries in distress, it is almost
22 invariable that employees feel the brunt of an employer crisis first, thus they bear the
23 highest risk if this transaction proceeds. Employees' risk from this transaction would be

1 followed by consumers of the employer's goods or services. This would be particularly
2 true in this case since consumers, particularly in rural areas, have few practical
3 alternatives. To the extent that there are layoffs, wage cuts or similar actions that reduce
4 employees' buying power, the communities in which they live will likely feel the greatest
5 impact, while (because of their greater size and more diversified economies) states will
6 feel the brunt to a lesser degree. Shareholders may well suffer financial losses, but their
7 financial and emotional pain is likely to be much smaller in comparison to that of those
8 who are more directly affected by an employer crisis. While lenders bear some risk, in
9 this transaction they appear to be well collateralized; certainly more than any other group
10 that would be exposed to risk as an result of this transaction. Least at risk, of course, is
11 Verizon, though its stockholders (who will become involuntary FairPoint investors) could
12 suffer as well.

13 **Q. Why are you particularly concerned about how FairPoint's financial condition**
14 **might affect FairPoint's employees?**

15 A. I am particularly concerned about the fact that some \$257 million in pension and OPEB
16 charges are projected to be non-cash expense (thus increasing FairPoint's ability to pay
17 dividends far beyond its earnings), and will simultaneously contribute to FairPoint's
18 negative shareholders' equity account. My concern is that the very large annual projected
19 declines in shareholders' equity (almost \$90 million per year) are symptomatic of
20 FairPoint's plan to extract excessive amounts of cash from NNE while incurring
21 significant additional obligations via unfunded employee benefit obligations.

22 I am concerned that, if it is confronted with financial stress (as appears likely),
23 FairPoint would be tempted to reduce or eliminate its current and future OPEB-related

1 costs. As noted above, FairPoint projects \$257 million in non-cash pension and OPEB
2 charges for the 2008-2015 period and these non-cash expenses will be booked as
3 liabilities on the company's balance sheet.

4 Which gets me back to Embarq. As noted above, this telecommunications
5 company just recently booked a \$196 million gain to its shareholder equity account
6 through the alteration or elimination of OPEBs:

7 "During the second quarter of 2007, Embarq amended its other postretirement medical
8 and life insurance plans to eliminate medical coverage and Medicare premium subsidies
9 for Medicare-eligible retirees and Medicare-eligible beneficiaries, effective January 1,
10 2008. In addition, these amendments capped the maximum amount of life insurance
11 benefits through the company-sponsored plan for qualified retirees at \$10,000, effective
12 January 1, 2008, and eliminated company-provided life insurance coverage for retirees
13 who have benefits through a separate subsidiary company-sponsored plan, effective
14 September 1, 2007."¹⁸
15

16 I absolutely do not endorse Embarq's actions, but I understand the financial
17 pressures that caused it – and that's what worries me about FairPoint. I fear that
18 FairPoint will face severe financial pressures and that it is likely to react in the same way
19 that Embarq just did. I have both observed and been directly involved with companies
20 that seek to reduce cash expenses and liabilities through reductions in labor-related costs,
21 which many seem to view as a form of "low hanging fruit." It is this understanding that,
22 absent a specific contractual requirement, companies can reduce or even eliminate such
23 non-funded benefits as retiree health care, via reductions in employer-paid premiums for
24 retirees, changes in coverage, or the outright elimination of such benefits. I would note
25 that Verizon has recently taken such steps for management retirees (or future retirees).

¹⁸ Embarq 10Q, August 1, 2007, p. 8

1 **Q. FairPoint rejects your assertion that it entered into this transaction out of**
2 **desperation, and says that it certainly does not represent a “hail Mary” on the**
3 **company’s part.**

4 A. FairPoint scoffs at my suggestion that this transaction represents something of a “hail
5 Mary” for FairPoint.¹⁹ It also objected vigorously to similar observations made by an
6 analyst at Morgan Stanley Research, who wrote in early June:

7 “We are concerned that FairPoint’s apparent expectation that it will not be
8 able to generate enough cash to pay its current dividend without the
9 proposed merger with Verizon’s NH, ME, and VT lines suggests that the
10 company is in a vulnerable position. . . . [W]e are concerned that FairPoint
11 may be in a position where the Verizon NE lines transaction has become a
12 necessity . . . rather than an option.”²⁰

13 I address this issue in more depth below (during my discussion of RB Schedule 3R) and
14 in my confidential testimony (on pp. 17-18).

15 ***B. Supplemental Testimony Based on New or Updated Information***
16

17 **Q. Since you submitted your public direct testimony in Vermont, have you had the**
18 **occasion to analyze information that was not available at that time?**

19 A. Yes I have. This includes additional SEC filings, FairPoint’s and Verizon’s Hart Scott
20 Rodino filings, and other documents and spreadsheet models produced in discovery in
21 this case and the parallel proceedings in New Hampshire and Maine.

22 **Q. FairPoint has suggested that it could have entered into this transaction even without**
23 **the \$40 million in direct support from Verizon, the \$55 million in cash that it**

¹⁹ See for example, King Rebuttal, pp. 30-32.

²⁰ Morgan Stanley Research, “FairPoint Communications, Lowering 2008 Estimates on New Company Forecasts,”
June 5, 2007, p. 4.

obtained from selling the cellular partnership to Verizon Wireless, and the \$15 million in deferred billing from Capgemini. Do you concur?

A. I think that is highly unlikely for the following reasons:

1. At the time of the transaction, FairPoint had approximately \$84 million available from its revolving credit facility, about \$36 million shy of the projected \$110 million in pre-closing costs.

2. While FairPoint might in theory have been able to obtain additional funds, either by increasing the credit available through the revolver or from another source, it would have confronted the prospect not only of breaching its covenant-driven leverage ratio for paying dividends but it would have violated a key covenant in its indebtedness.

As can be seen in the table below, FairPoint's "Leverage Ratio" covenants were a maximum of 5.00:1.00 for continued payment of dividends and 5:25:1:00 to remain in compliance with the covenants of FairPoint's indebtedness.

Covenant Leverage Ratio "Triggers" in Effect at the time of the transaction	
Suspension of Dividends	5:00:1.00
Covenant Non-Compliance	5:25:1:00

As can be seen below, if FairPoint were able to borrow an additional \$110 million to fund the transaction itself, its Leverage Ratio would have risen from 4.58:1.00 to 5.42:1.00, not only forcing it to suspend dividend payments but also violating a key covenant ratio and placing it in at least technical default on its indebtedness.

	Adjusted EBITDA (Millions)	Net Debt (Millions)	Leverage Ratio (Net Debt-to-Adjusted EBITDA)
FairPoint, Year-End 2006	\$131.3	\$602.0	4.58
FairPoint with \$110 million in new debt	\$131.3	\$712.0	5.42

1 Of course, it is possible that FairPoint might have been able to convince its
2 lenders to raise the leverage ratio triggers, as it subsequently did after the transaction was
3 signed and including the \$110 million in pre-closing funds and forbearance. However,
4 that seems unlikely in the overall context of this transaction, where FairPoint was already
5 going to be stretched very thin in making the deal work under the original terms.

6 3. It is also important to note that the threat – or certainty – of a freeze on
7 dividend payments would have almost certainly resulted in a steep decline of FairPoint's
8 stock price. That in turn would have reduced the value of the 53.8 million new FairPoint
9 shares that the company planned on using as "currency" in the transaction (valued at
10 \$1.015 billion based on FairPoint's then-prevailing share price). Without speculating
11 about the magnitude of a FairPoint stock decline in the face of suspended dividends, I
12 would simply note that for every \$1 that FairPoint's stock declined below the
13 transaction's \$18.88 implied value of the company's shares, FairPoint would lose about
14 \$54 million in company stock "currency" that could be used in the transaction.²¹

²¹ Indeed, after an initial increase, FairPoint's stock price has declined rather steadily. FairPoint's final SEC form 424(b)(3) Prospectus, filed on July 19, 2007, for the first time quantified the projected reduction in value to Verizon shareholders. Relying on the \$17.20 closing price of FairPoint stock on July 12, 2007, the company revised its estimate of the approximate value Verizon stockholders will receive in the merger to \$936 million (this projection was based on a slightly greater number of shares to be issued, 54.1 million versus the initially forecast 53.8 million). Of course, the actual value to Verizon shareholders will not be known with certainty until (and if) the transaction closes. For example, FairPoint's closing stock price on August 9 was \$15.99, reducing the implied value to Verizon shareholders to about \$865 million (about \$150 million below the initially projected \$1.015 billion).

1 **Q. In your Confidential Testimony, you discuss the FairPoint financial model²² to**
2 **which you were recently given access. Without disclosing any allegedly confidential**
3 **information, please describe your conclusions about this model.**

4 A. As a tool for evaluating alternative assumptions – or simply to incorporate updated
5 information – the FairPoint financial model is extraordinarily cumbersome. It contains a
6 huge number of “hard coded” numbers, many of which should – but do not – change
7 when other parts of the model are altered. Many of these hard coded numbers contain up
8 to thirteen decimals (far beyond what I believe would be coded by hand), indicating that
9 they were placed there by some sort of computer operation. The model also contains
10 hundreds of cells with formulas that include hard coded numbers, sometimes as part of
11 the addition of multiple numbers, other times imbedded as part of more complex
12 computation routines.

13 As provided to me, this is not actually a model in the sense that I believe most
14 analysts would understand the term; for example, it is not capable of performing
15 “sensitivity analyses” to test various simple or complex scenarios. While it may contain
16 FairPoint management’s views (or assumptions or hopes) regarding the prospects of the
17 NNE transaction, I believe that even an experienced user would have significant
18 difficulties using it to test alternatives, make changes in many assumptions, or reflect
19 updates for new data.

20 Overall, my impression of the Discovery Model is of a large, complex jigsaw
21 puzzle, with some of the pieces already glued to the table.

²² Referred to by FairPoint as the Discovery Model

1 **Q. You have prepared three new public Schedules for your rebuttal testimony. Please**
2 **describe them.**

3 **A. Schedule RB-1R: Selected FairPoint Financial Projections: 2008 - 2015 (as of**
4 **January 2007)**

5 Schedule RB-1R compiles key financial projections for the combined
6 FairPoint/NNE operations from 2008 to 2015, as disclosed by FairPoint in multiple SEC
7 filings.²³ In my experience, it is exceedingly rare for a company to publicly disclose
8 transaction-related financial projections with the level of detail or over the period of time
9 included in these filings. However, they are similar-to-identical to the confidential data
10 and projections that FairPoint and its advisors generated in early January 2007 and that
11 have been produced by FairPoint in these proceedings.²⁴

12 The projections and data in RB-1R were provided by FairPoint to its investment
13 advisor, Deutsche Bank, which in turn relied upon them in rendering its fairness opinion
14 to FairPoint's Board of Directors on January 15, 2007 (the meeting at which FairPoint's
15 Board approved the Verizon Northern New England transaction). In its July 19, 2007
16 Proxy/Prospectus filing, Fairpoint states:

17 “These financial projections were prepared in January 2007, based solely
18 on information available at that time, by FairPoint's management. While
19 the financial projections were prepared in good faith, no assurance can be
20 given regarding future events. In addition, the financial projections do not
21 reflect FairPoint's current view on the business of the combined
22 company.” (p. 74)

²³ These data were first disclosed on May 25, 2007 in an amendment to FairPoint's SEC Form S-4. They were included in subsequent amendments and in FairPoint's SEC Form 424B3 (final Proxy/Prospectus), July 19, 2007, pp. 74-84; "Material Projected Financial Information Provided to Deutsche Bank, Financial Advisor to FairPoint"

²⁴ There are minor differences among various sets of projections and data that FairPoint has provided and that were produced shortly before the January 15, 2007 transaction agreement. FairPoint attributes these differences to evolving assumptions, updated data, and analytical techniques.

1 Despite this disclaimer, the projections and data extracted from these disclosures
2 for RB-1R were “prepared by, and [are] the responsibility of, FairPoint's management.”
3 Clearly, they reflected management's view at the time that the FairPoint Board approved
4 the transaction. They were also the most up-to-date information available to the FairPoint
5 Board of Directors as it considered the proposed transaction.

6 The importance of these projections cannot be overstated. Even though FairPoint
7 says they no longer represent the company’s updated view of the transaction, the fact
8 remains that these were the projections that FairPoint’s Board of Directors relied upon in
9 approving the transaction. Based on my review of FairPoint’s “highly confidential”
10 financial model and other information provided in this proceeding, I have verified that the
11 company’s January 2007 financial projections for the transaction have been updated and
12 materially changed. However, while some computations and ratios have been adjusted,
13 the company’s basic plan remains fundamentally unaltered.²⁵

14 In Schedule RB-2R, discussed below, I focus on what I believe to be some telling
15 financial ratios derived from RB-1R, but I will comment on two specific measures here.

16 The first is an item called “Pension & OPEB Cash Adjustment.” The acronym
17 OPEB stands for “Other Post Employment Benefits,” and my understanding is that it is
18 almost completely comprised of retiree health care obligations. The reason for the “Cash
19 Adjustment” is that, while FairPoint will incur annual pension and OPEB expenses, it

²⁵ The financial model which I was provided on July 2, 2007, is itself “frozen” in time. Referred to as the “Discovery Model” (because FairPoint was required to produce it during the “discovery” process in these proceedings), it does not contain FairPoint projections subsequent to April 19, 2007, when a confidential partial print version of the model was provided in another proceeding. The results displayed in this printout are identical to those in the Discovery Model. The 19-page document containing identical detailed FairPoint financial projections was first confidentially disclosed in the Vermont proceedings (Attachment FP:DPS.1-86). The Labor Intervenors and others are continuing to press FairPoint for updated financial information and projections, but the Discovery Model remains the most up-to-date comprehensive set of projections that the company has provided.

1 will initially be required to pay out little if any *cash* on these expenses. The reason for
2 this is that FairPoint will only accept financial responsibility for active NNE employees
3 at the time that the proposed transaction closes. While FairPoint will be required to fund
4 its pension obligations as they are incurred, the OPEB expenses are completely unfunded
5 and are only payable when an eligible participant retires. FairPoint may have some non-
6 cash pension expenses (due to accounting and actuarial conventions), but most of the
7 Pension & OPEB Cash Adjustment is certainly attributable to retiree health care benefits.
8 For the 2008 – 2015 period, FairPoint projected (in January 2007) that it would make
9 \$257 million less in Pension & OPEB cash payments than it actually would incur.²⁶ I
10 would note that this amount is roughly comparable to FairPoint's projected \$289 million
11 "Cash Flow After Dividends" for the same period.

12 The difference between the expenses FairPoint recognizes on its income statement
13 and the cash that it projects it will actually pay out in any particular year is reflected in a
14 cash adjustment on its statement of cash flows (as non-cash expenses). This amount is
15 also booked as a future liability on the company's balance sheet.

16 This leads me to my second comment on this schedule. The projections that
17 FairPoint management prepared for the Board of Directors reflected Total Shareholders'
18 Equity "going negative" in 2013 and falling to a \$218 million deficit in 2015.²⁷

19 A projected negative shareholder equity is one of many reasons that I believe the
20 Commission should be deeply concerned about the risk inherent in this proposed

²⁶ No information was provided about subsequent cash payments to fund previous years' expenses for the 2008-2015 period reflected in FairPoint's Proxy/Prospectus. Thus, the \$257 million total cash adjustment may be somewhat greater than the net non-cash impact of this item.

²⁷ FairPoint's shareholder value has already eroded by \$57 million or 21%, from its early 2005 Initial Public Offering through March 30 2007

1 transaction. FairPoint has demonstrated that it is “focused like a laser” on cash flows. As
2 I argue elsewhere, it relies on depreciation to fund its high-yield dividend policy and it
3 doesn’t seem particularly concerned that it pays far higher amounts in dividends than it
4 earns in profits. The above-mentioned Pension & OPEB Cash Adjustment is a non-cash
5 expense just like Depreciation and Amortization. However, Pension & OPEB liabilities
6 are obligations that must be repaid in the future. At some point, FairPoint will likely find
7 itself in a position where the required payouts from past non-cash Pension and OPEB
8 expenses will become material, eventually exceeding its new Pension & OPEB cash
9 adjustments. The non-cash pension expenses are likely to be both transient and minor
10 compared to the very large and unfunded OPEB expenses and future liabilities. As
11 mentioned above, my concern is that once FairPoint is confronted with actually paying its
12 OPEB obligations, it will seek ways to avoid paying them (or at the very least, continue
13 to incur new such obligations). It is my understanding that, absent specific contractual
14 requirements such as might be contained in a collective bargaining agreement, companies
15 are free to reject – walk away from – unfunded OPEB obligations such as retiree health
16 care benefits. With a projected \$218 million negative shareholders’ equity (in the
17 January 2007 projections) and looming OPEB payment requirements, I believe that
18 FairPoint would be tempted to find ways to avoid ever having to make good on these
19 obligations.

20
21 **Schedule RB-2R: Selected Summary Metrics from FairPoint Financial Projections:**
22 **2008 - 2015 (as of January 2007)**

1 This schedule relies on data reported in RB-1R (which in turn relies on FairPoint
2 management financial projections made in January 2007). I extracted the projected 2008
3 – 2015 totals from four key financial metrics: Net Income / (Loss), Dividends Paid to
4 Common Stockholders, Depreciation and Amortization, and Pro Forma Combined
5 Capital Expenditures. I then make four computations which I believe highlight the
6 potential riskiness of the proposed transaction. These computations reveal that, at the
7 meeting at which FairPoint's Board of Directors approved the transaction, FairPoint
8 management was projecting the following:

- 9 • Over the period 2008-2015, FairPoint would pay 4.6 times more in dividends
10 than it anticipated earning in Net Income. Put another way, FairPoint
11 management was projecting that it would book \$890 million less in profits
12 than it would pay out to stockholders in dividends.
- 13 • During this same period, FairPoint management projected that it would only
14 reinvest 63% of its Depreciation and Amortization cash flows; D&A was
15 projected to be \$843 million – or roughly \$100 million per year -- greater than
16 capital expenditures. I would note that the 2008 CapEx estimates are more
17 than double subsequent years, and include one-time outlays for DSL
18 expansion and for the back office and network systems that FairPoint must
19 create if it is to operate the businesses it proposes to acquire.

20 **Schedule RB-3R: Lehman Brothers / Morgan Stanley Analysis of FairPoint's Cash**
21 **Flow Prospects Absent the Verizon Northern New England Transaction**

22 Schedule RB-3R extracts data from another highly unusual set of projections that
23 FairPoint first disclosed in a July 2, 2007 amendment to its SEC Form S-4. The

1 projections were jointly produced by two other FairPoint financial advisors (Lehman
2 Brothers and Morgan Stanley). They were presented to FairPoint's Board of Directors on
3 January 10, 2007 and January 14, 2007 and are referred to as Annex C-1 and C-2 in the
4 July 2 filing (as well as in the July 19 Proxy/Prospectus).

5 Both Annexes were styled as "discussion materials," and Annex C-2 (January 14)
6 is clearly an update of the much more extensive Annex C-1 (January 10). Until it was
7 filed with the SEC, the very existence – much less a copy -- of Annex C-1 had not been
8 disclosed by FairPoint to the parties in this proceeding. A heavily redacted copy of
9 Annex C-2 had been disclosed previously.²⁸ The redactions mostly involved projections
10 for two scenarios called "Falcon Acquisition Case" and "Falcon Status Quo." "Falcon"
11 was the code name for FairPoint, and both of these scenarios clearly contemplate
12 FairPoint's future *without* the Verizon Northern New England transaction.

13 Schedule RB-3R reproduces the final set of "Falcon" scenarios from the January
14 document (C-2).

15 Both the "Acquisition" and "Status Quo" cases contain projections from 2008
16 through 2015 for four categories: Free Cash Flow (FCF) Before Dividends (\$ millions),
17 FCF/Share, Dividend Payout Ratio, and Leverage. Both scenarios show a company with
18 a worsening financial condition (at least as measured by these four metrics), with
19 declining free cash flows and rising dividend payout and leverage ratios. The Status Quo
20 case produces what I would describe as an untenable situation for FairPoint, but the
21 Acquisition case is not that much better.

²⁸ DPS 1-69.3

To demonstrate this point, I will focus on one metric for the two scenarios:
 Dividend Payout Ratio (the proportion that dividends represent of Free Cash Flow before
 dividends):

Projected Dividend Payout Ratios

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
<i>Falcon Acquisition Case</i>	92%	93%	97%	98%	101%	118%	125%	150%
<i>Falcon Status Quo</i>	97%	106%	120%	132%	150%	172%	202%	256%

Unless it is willing (and permitted) to dip into savings or borrow money to pay
 dividends, a firm obviously cannot pay out more than 100% of its free cash flows. Under
 the Status Quo scenario, FairPoint’s payout ratio would be 106% in 2008.²⁹ Under this
 truly unreal scenario, the company would be paying \$2.56 for every \$1.00 of free cash
 flow by 2015.

The Acquisition Case scenario presumably assumes some level of acquisition
 activity in the future; it has slightly higher initial free cash flows, which decline much
 less precipitously than the Status Quo scenario. However, FairPoint’s payout ratio still
 tops 100% in 2012 and rises to 150% by 2015. Even with continued – if more modest –
 acquisition activity, FairPoint’s financial advisors’ projections do not paint a picture of a
 sustainable business model.³⁰

Based on FairPoint’s financial advisors’ own analysis, I conclude that FairPoint
 management and its Board of Directors believed that they had little alternative to
 pursuing the Verizon Northern New England acquisition, whatever the risks.

²⁹ FairPoint reported that its 2005 payout ratio was 87%.

³⁰ Annex C-1 (the January 10, 2007 Lehman Brothers / Morgan Stanley “discussion materials” document) also contains Acquisition and Status Quo case projections. These are more pessimistic than the revised projections reflected in the January 14 update (C-2). For example, the Acquisition Case scenario begins with a slightly lower payout ratio in 2008 (90%), but rises more rapidly to 106% in 2012 and to 160% in 2015. The Status Quo case projections start at a payout ratio of 103% in 2008 and rise to 331% in 2015.

1 As I mentioned earlier in my testimony, I believe that one could view the NNE
2 acquisition as a bit of a “hail Mary.” Certainly, the Acquisition Case and Status Quo
3 scenarios presented to FairPoint’s Board by Lehman Brothers and Morgan Stanley
4 strongly reinforce this impression. The company appeared to be facing a huge challenge
5 to its business model, at the very least. The NNE acquisition provides a way to “solve”
6 this looming crisis (or, more accurately, to postpone it for a few years), if only FairPoint
7 could pull it off. I expand on this argument in my confidential rebuttal statement.

8 The deep concern that I have is that, confronted with a looming potential crisis,
9 FairPoint’s Board of Directors and management were far less motivated to avoid the
10 fundamental risks inherent in this transaction than I believe they should have been.

11 Of course, FairPoint has been abetted by Verizon, which needed a willing partner
12 who had the very special attribute of being small. Verizon needed FairPoint to do this
13 deal, and judging by the \$40 million in pre-closing support and \$55 million from the
14 purchase of FairPoint’s interest in the cellular partnership, Verizon was willing to go a
15 good distance to get this deal done. Ultimately, this transaction could transform
16 FairPoint or it could severely, even fatally, wound the firm. As I have pointed out in this
17 Statement, there are large degrees of risk for everyone, and FairPoint and its shareholders
18 are no exception.

19 **Q. In his testimony, Labor witness Dr. Peres discusses the need for FairPoint to make a**
20 **strong commitment to improving Verizon’s substandard service. From your review**
21 **of FairPoint’s financial projections that were not available to you when you**
22 **prepared your direct testimony, is FairPoint making such a commitment?**

1 A. No, FairPoint's financial projections do not show a strong commitment to improving
2 service quality. For example, FairPoint's projected capital budget for the years 2008
3 through 2015 shows that FairPoint is budgeting 25 times more in capital spending for
4 growth than it is for service improvement. In fact, FairPoint's capital budget shows
5 spending on service improvement would constitute only about 2% of its capital spending
6 in each year.

7 **Q. In your opinion, do FairPoint's capital spending priorities show a strong**
8 **commitment to improving service quality?**

9 A. No, FairPoint is focused on spending money to improve its profitability and try to stem
10 the decline in line losses. FairPoint's proposed capital budget shows that it will be
11 making just minimal investments to improve service quality to existing customers.

12 **Q. You have said that there were serious risks that FairPoint would not be able to**
13 **execute this transaction. Please elaborate.**

14 A. Based on both this testimony, and certain confidential information that I have evaluated
15 in the context of this proceeding, it is clear that there are a number of entirely credible
16 scenarios that would result in a financial crisis for FairPoint. Such a crisis would require
17 FairPoint to make some very hard decisions, each of which could have its own negative
18 ramifications. They would all revolve around insufficient cash to fund all of the promises
19 that FairPoint has made to its customers, employees, communities, regulators,
20 shareholders, and lenders.

21 One public example that I can mention is the recent decision by a Hearing
22 Examiner in Maine determining that Verizon had overcharged its customers by \$32.4
23 million in 2004. While that proceeding is still under way, and I obviously cannot know

1 the ultimate outcome, a loss of income of this order of magnitude – presumably on an
2 annual basis – could be a body-blow to FairPoint’s projections. The \$32.4 million
3 represents over 21 % of Spinco/NNE’s pro forma adjusted 2006 operating income (29%
4 before pro forma adjustments and 16% of the combined entities’ 2006 pro forma adjusted
5 2006 operating income). While this loss in revenue, were it to occur, would likely be
6 somewhat mitigated by a reduction in taxes (to the extent that FairPoint would actually be
7 paying a material amount in cash taxes), much of it would flow to the FairPoint bottom
8 line. This would significantly reduce FairPoint’s free cash flow.

9 **Q. It seems that much of the risk you discuss is based on FairPoint’s projected**
10 **reductions in Verizon NNE’s operating costs. Can you explain how FairPoint has**
11 **developed its cost-savings estimate?**

12 A. FairPoint recently provided a spreadsheet that contains details of its projected synergies
13 savings.³¹ This spreadsheet, which I refer to as the Synergy Model, contains the same
14 summary data as was previously provided in another confidential FairPoint document³².

15 While I cannot publicly describe the detail contained in these documents, I can
16 observe that FairPoint argues that it will not be required to pay the costs that Verizon
17 currently allocates to its NNE operations for back office and network systems and
18 operations. And while FairPoint has contracted with CapGemini to replace these some
19 600 systems, the company argues that it will be able to successfully replicate all of
20 Verizon’s systems and operations, while saving \$60-\$75 million in the process.

³¹ Attachment A.DPS:FP.1-86.2. In late June, I received a version of this spreadsheet for use in the Maine and New Hampshire proceedings. I received a functionally identical copy of that spreadsheet on August 2 for use in Vermont.

³² FairPoint: DPS:FP.1-78

1 **Q. In your direct testimony, you recommended that the Commission reject the**
2 **proposed transaction, and you said that you did not believe financial conditions**
3 **could protect FairPoint’s customers or employees. Has your position changed?**

4 **A.** I continue to recommend that the Commission reject the transaction because FairPoint is
5 not financially fit to own and operate Verizon Vermont and the other NNE operations.
6 As I said, I do not believe that conditions can fully protect the interests of Verizon’s
7 customers and employees in Vermont. I believe the public would be better served by the
8 Commission rejecting the transaction, rather than approving it and having to deal with the
9 consequences posed by FairPoint’s lack of experience and precarious financial condition.

10 If the Commission disagrees with me, however, and decides to approve the
11 transaction, that approval must be conditioned in a way that at least tries to avoid (or at
12 least minimize the adverse impacts from) serious financial problems for local telephone
13 operations in Vermont. Specifically, I recommend the following conditions related to
14 FairPoint’s financial condition:

- 15 1. NNE will be prohibited from paying dividends to FairPoint Communications
16 Inc. (or any other affiliate thereof) (collectively “FairPoint Parent”) or from
17 otherwise transferring cash to FairPoint Parent through loans, advances,
18 investments or other means that would divert NNE’s moneys, property or
19 other resources that is not essentially or directly connected with the provision
20 of non-competitive telecommunications service if NNE fails to meet or exceed
21 the standard for a majority of the service quality measures (see the testimony
22 [rebuttal?] of Dr. Peres for the types of service quality conditions that should
23 be established for FairPoint).
- 24 2. Dividends on common stock of FairPoint’s existing operations in Vermont
25 must be suspended if service quality at FairPoint’s existing operations in
26 Vermont deteriorates, using the same criteria to be established for NNE (as
27 discussed by Dr. Peres).
- 28
- 29

3. The financing for the acquisition will not be secured by NNE's assets, nor shall NNE or its affiliates be allowed to pledge NNE's assets.
4. NNE will not provide any financial guarantees to facilitate this, or any other acquisition.
5. The amount of annual dividends NNE can distribute to FairPoint Parent is further limited as follows:
 - a. The cumulative dividend NNE can declare in any year may not exceed the difference between that year's earnings (income or loss) before interest, taxes, depreciation, and amortization (EBITDA) and 100% of its depreciation expense. This restriction will require that an amount of cash, equal to 100% of that year's depreciation expense, will be available for NNE's capital expenditures.
 - b. In any year that the amount of depreciation expense retained by NNE is in excess of its capital expenditures, NNE shall account for such funds in a subaccount of Account 1410, Other Noncurrent Assets. The cumulative annual depreciation expense retained at NNE will assure adequate funds are available to complete future capital expenditures, as required.
 - c. In years when the total depreciation expense does not cover capital expenditures, NNE may use the accumulated depreciation funds to pay for this incremental amount of capital expenditures, provided that NNE notifies the Commission of such a need no later than 45-days prior to the use of the funds.
 - d. Suspend this dividend restriction to the extent NNE is able to maintain an average daily balance in the depreciation fund subaccount of Account 1410 for a calendar year of 1.0 times its average annual capital expenditures for the last five calendar years. The dividend restriction will become operative whenever this criterion is not satisfied. Further, we will suspend the restriction if FairPoint obtains an investment grade bond rating.
6. NNE must maintain a consolidated common equity ratio of at least 40% of total capitalization before any declaration of a dividend on common stock. Total capitalization includes: long term debt (including current sinking fund requirements), short term debt (including capital leases), minority interest, and stockholders' equity. Further, no dividend payment will be permitted which would cause NNE's consolidated common equity ratio to fall below 40%.

1 7. NNE and its subsidiaries shall be prohibited from making any loans or
2 financial advances to FairPoint.
3
4

5 **Q. In your opinion, are these conditions commercially reasonable?**

6 A. Yes, in my opinion these conditions are commercially reasonable. By that I mean that a
7 company providing local telephone service should be able to continue to operate reliably
8 and maintain its network without violating these restrictions. In my opinion, these
9 conditions would not pose an undue financial burden or hardship on a well-run,
10 appropriately capitalized telephone company.

11 **Q. To the best of your knowledge, have conditions like this been imposed in other**
12 **transactions?**

13 A. I am not a regulatory expert, but I am advised by counsel that conditions nearly identical
14 to these have been imposed on FairPoint by regulatory commissions in New York and
15 Illinois.³³ I have reviewed copies of those orders (as provided by counsel), and it appears
16 that FairPoint voluntarily agreed to conditions very similar to these in order to (a) obtain
17 approval for an acquisition of a small telephone company (New York), and (b) obtain
18 approval for a public offering of its common stock (Illinois). The fact that FairPoint has
19 agreed to very similar conditions in other jurisdictions reinforces my opinion that these
20 are commercially reasonable conditions.

³³ *Joint Petition of Berkshire Telephone Corporation, FairPoint Communications, Inc., MJD Ventures, Inc. and FairPoint Berkshire Corporation for Approval of the Merger of FairPoint Berkshire Corporation with and into Berkshire Telephone Corporation*, CASE 03-C-0972, New York Public Service Commission, 2005 N.Y. PUC LEXIS 124 (March 18, 2005); *FairPoint Communications, Inc., C-R Telephone Company, The El Paso Telephone Company, Odin Telephone Exchange, Inc. and Yates City Telephone Company - Joint Application for approval of the Recapitalization of FairPoint Communications, Inc. pursuant to Sections 7-203 and 7-204 and for other relief*, Illinois Commerce Commission Docket No. 04-0299, 2004 Ill. PUC LEXIS 278 (May 26, 2004).

1 I am also advised by counsel that other state utility commissions have imposed
2 financial conditions, including limitations on dividend payments, that are designed to
3 protect a regulated utility from adverse financial effects of unregulated or out-of-state
4 operations of a holding company. These provisions are generally known by the term
5 “ring fencing” because they, in effect, build a financial fence around the utility to protect
6 it from unregulated actions of the parent company or other affiliates.

7 **Q. In addition to these financial conditions, are there other types of conditions the**
8 **Commission should consider if it rejects your primary recommendation?**

9 A. Yes. In addition to financial conditions, the Commission should consider conditions
10 related to service quality (as discussed by Dr. Peres). The Commission also should adopt
11 conditions related to the transition of billing, network operations, and customer service
12 systems from Verizon to FairPoint. This type of condition might require an independent
13 auditor to verify the readiness of FairPoint's computer and operational systems.
14 Similarly, the Commission should consider requiring an independent audit of the
15 condition of Verizon's facilities, including an assessment of the expenditures that would
16 be necessary to bring them up to acceptable standards. The Commission then could
17 determine whether Verizon should be responsible for any or all of the cost of making
18 necessary improvements.

19 **Q. If the Commission rejects this deal, aren't there risks associated with Verizon's**
20 **continued ownership of the Vermont operations?**

21 A. Yes, there are also risks associated with Verizon's continued ownership of assets it no
22 longer wants, but those risks are more evenly allocated. Moreover, assuming Verizon is
23 intent on divesting itself of the Northern New England assets, a rejection of this high-risk

1 transaction will send a clear message to the company that it must create a transaction that
2 more equitably balances the risks to all of NNE's constituents.

3 **Q. Earlier, you mentioned that the Commission could establish “benchmarks” for a**
4 **Verizon divestiture of its Vermont operations. What do you mean by that?**

5 A. By “benchmarks” I mean that in addition to rejecting this transaction, the Commission
6 also may wish to put Verizon on notice about the types of requirements that would be
7 expected of any proposed acquirer of Verizon Vermont.

8 **Q. What types of benchmarks would you propose?**

9 A. I would propose that the Commission establish four broad benchmarks that must be met
10 if it is to approve any proposed acquisition of Verizon Vermont (as well as any other
11 Verizon businesses that might be part of a new proposed transaction). In the context of
12 any proposed transaction in its entirety, the proposed acquirer must demonstrate that it
13 has:

- 14 1. Adequate capitalization;
- 15 2. Adequate reserves;
- 16 3. Adequate infrastructure; and,
- 17 4. A demonstrated ability to absorb, integrate, and operate entities of comparable
18 size and complexity to the entities the acquirer is proposing to acquire.

19 **Q. Just to be clear, in your opinion, does FairPoint meet any of these benchmarks?**

20 A. No, it does not. FairPoint fails on every reasonable measure of a competent successor to
21 Verizon Vermont.

22

1 **Q. Despite the conclusions and recommendations you recite immediately above, are**
2 **there any circumstances under which the Labor Intervenors could be prepared to**
3 **support the acquisition of Verizon NNE by FairPoint?**

4 **A.** For the transaction as proposed, the Labor Intervenors position is that there is no set of
5 conditions under which the transaction should be approved by the Vermont PSB. The
6 conditions that and Dr. Peres and I have suggested are conditions we would recommend
7 only if Labor Intervenors' primary recommendation (to disallow the transaction) is
8 rejected by the Board.

9 However, the Labor Intervenors believe that there are circumstances under which
10 they could be prepared to support the acquisition of the Verizon NNE business by
11 FairPoint. These circumstances would involve a different transaction than Verizon and
12 FairPoint negotiated and would include:

- 13 • Verizon contributing a significant amount to enable the assets it is abandoning
14 to be upgraded to meet the standards to which Verizon has been obligated –
15 but failed – to meet;
- 16 • FairPoint agreeing to fundamentally transform its business model from one
17 that is acquisitions-driven to a true, operating NNE ILEC; in effect, rather
18 than absorbing NNE and using it as a base for future acquisitions, FairPoint
19 would have to become NNE and become focused on being a world-class
20 telecom operating company; and,
- 21 • The imposition by the PSB of the conditions the Labor Intervenors have
22 recommended through the Dr. Peres' and my testimonies.

1 **Q. Does this conclude the first (largely public) portion of your rebuttal testimony?**

2 A. Yes it does.

Selected FairPoint Financial Projections: 2008 - 2015 (as of January 2007)

(\$ in Millions)	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	2008-2015 Totals
Pro Forma Combined Revenues	\$1,427	\$1,418	\$1,421	\$1,414	\$1,404	\$1,399	\$1,397	\$1,394	\$11,274
% Y-o-Y Growth		-0.6%	0.2%	-0.5%	-0.7%	-0.4%	-0.1%	-0.2%	
Pro Forma Combined Operating Expense (excluding depreciation)	\$961	\$874	\$883	\$890	\$895	\$903	\$911	\$917	\$7,234
% Y-o-Y Growth		-9.1%	1.0%	0.8%	0.6%	0.9%	0.9%	0.7%	
Pro Forma Combined Operating Expense (including depreciation)	\$1,291	\$1,196	\$1,197	\$1,192	\$1,187	\$1,179	\$1,158	\$1,135	\$9,535
% Y-o-Y Growth		-7.4%	0.1%	-0.4%	-0.4%	-0.7%	-1.8%	-2.0%	
Net Income / (Loss)	(\$32)	\$26	\$30	\$32	\$33	\$38	\$53	\$68	\$248
% Y-o-Y Growth		-181.3%	15.4%	6.7%	3.1%	15.2%	39.5%	28.3%	
Pension & OPEB Cash Adjustment	\$27	\$29	\$30	\$31	\$33	\$34	\$36	\$37	\$257
% Y-o-Y Growth		7.4%	3.4%	3.3%	6.5%	3.0%	5.9%	2.8%	
Depreciation and Amortization	\$330	\$322	\$314	\$302	\$292	\$276	\$247	\$218	\$2,301
% Y-o-Y Growth		-2.4%	-2.5%	-3.8%	-3.3%	-5.5%	-10.5%	-11.7%	
Pro Forma Combined Capital Expenditures	\$344	\$167	\$163	\$159	\$157	\$156	\$156	\$156	\$1,458
% Y-o-Y Growth		-51.5%	-2.4%	-2.5%	-1.3%	-0.6%	0.0%	0.0%	
Dividends Paid to Common Stockholders	\$142	\$142	\$142	\$142	\$142	\$142	\$142	\$142	\$1,136
% Y-o-Y Growth		0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	
Cash Flow After Dividends (Net Increase/Decrease in Cash Balance)	(\$176)	\$81	\$82	\$81	\$74	\$67	\$54	\$26	\$289
% Y-o-Y Growth		-146.0%	1.2%	-1.2%	-8.6%	-9.5%	-19.4%	-51.9%	
Total Shareholders' Equity/(Deficit)	\$490	\$375	\$264	\$155	\$46	(\$57)	(\$145)	(\$218)	NM
% Y-o-Y Growth		-23.5%	-29.6%	-41.3%	-70.3%	NM	NM	NM	

Note: These projections were provided by FairPoint to its investment advisor, Deutsche Bank, which in turn relied upon them in rendering its fairness opinion to FairPoint's Board of Directors on January 15, 2007 (the meeting at which FairPoint's Board approved the Verizon Northern New England transaction). In its SEC Form 424B3 (final Proxy/Prospectus) dated July 19, 2007, Fairpoint explicitly states that these projections "do not reflect FairPoint's current view on the business of the combined company" (p. 74). Nonetheless, they do reflect management's view at the time that the FairPoint Board approved the transaction. In addition, as I describe in my confidential testimony, FairPoint's projections have not changed so materially as to render the January projections meaningless.

Source: FairPoint SEC Form 424B3 (final Proxy/Prospectus), July 19, 2007, pp. 74-85; "Material Projected Financial Information Provided to Deutsche Bank, Financial Advisor to FairPoint"

Selected Summary Metrics from FairPoint Financial Projections: 2008 - 2015 (as of January 2007)

(\$ in Millions)	2008-2015 Totals	M E M O	
Net Income / (Loss)	\$248	4.6	Dividends-to-Net Income
Dividends Paid to Common Stockholders	\$1,138	(\$890)	Net Income Minus Dividends
Depreciation and Amortization	\$2,301	63%	Capital Expenditures as % of Depreciation
Pro Forma Combined Capital Expenditures	\$1,458	\$843	Depreciation Minus Capital Expenditures

Note: These projections were provided by FairPoint to its investment advisor, Deutsche Bank, which in turn relied upon them in rendering its fairness opinion to FairPoint's Board of Directors on January 15, 2007 (the meeting at which FairPoint's Board approved the Verizon Northern New England transaction). In its SEC Form 424B3 (final Proxy/Prospectus) dated July 19, 2007, Fairpoint explicitly states that these projections "do not reflect FairPoint's current view on the business of the combined company" p. 74). Nonetheless, they do reflect management's view at the time that the FairPoint Board approved the transaction. In addition, as I describe in my confidential testimony, FairPoint's projections have not changed so materially as to render the January projections meaningless.

Source: FairPoint SEC Form 424B3 (final Proxy/Prospectus), July 19, 2007, pp. 74-85; "Material Projected Financial Information Provided to Deutsche Bank, Financial Advisor to FairPoint"

Lehman Brothers / Morgan Stanley Analysis of FairPoint's Cash Flow Prospects Absent the Verizon Northern New England Transaction

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
"Falcon Acquisition Case" ¹								
Free Cash Flow (FCF) Before Dividends (\$millions)	\$61	\$61	\$61	\$64	\$65	\$58	\$55	\$46
FCF/Share	\$1.73	\$1.71	\$1.65	\$1.65	\$1.59	\$1.37	\$1.27	\$1.06
Dividend Payout Ratio	92%	93%	97%	98%	101%	118%	125%	150%
Leverage	4.80	4.90	4.90	4.80	4.90	4.90	5.10	5.30
"Falcon Status Quo" ¹								
Free Cash Flow (FCF) Before Dividends (\$millions)	\$57	\$53	\$47	\$43	\$37	\$33	\$28	\$22
FCF/Share	\$1.64	\$1.50	\$1.33	\$1.21	\$1.06	\$0.92	\$0.79	\$0.62
Dividend Payout Ratio	97%	106%	120%	132%	150%	172%	202%	256%
Leverage	4.60	4.80	5.00	5.30	5.60	6.00	6.40	6.90

¹ "Falcon" was the code name for FairPoint

² Annual dividend assumed to be \$1.59 per share

Source: FairPoint SEC Form 424B3 (final Proxy/Prospectus), July 19, 2007, Annex C-2, p. C-2-2; Lehman Brothers / Morgan Stanley; "Project Nor'Easter, Discussion Materials," "PF Detailed Summary—\$2.715 bn Purchase Price (New Base Case); Free Cash Flow Analysis"